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Economic Affairs Interim Committee 65th Montana Legislature

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9/13/2017

To: Economic Affairs Interim Committee Members
From: Pat Murdo, Committee Staff
Re: Proxy fiscal analysis for SB 371, a bill that, had it survived the 2017 session, would have revised workers' compensation insurance in Montana and dissolved Montana State Fund

SB 371, a bill that would have revised the workers' compensation insurance market in Montana by dissolving the Montana State Fund, was tabled and a fiscal note was never made available. As part of SJR 27's study of workers' compensation, staff asked the Montana State Fund and the Department of Labor and Industry to provide the materials that they had prepared for a fiscal note for SB 371. The material from the Montana State Fund is in the form of a fiscal note. The description from the Department of Labor and Industry generally references use of a trust set up by dissolution of Montana State Fund under the bill. No actual estimates were provided as to costs projected by the Department of Labor and Industry for assuming duties assigned to it by SB 371 except for reference to \$60 per page rule notice costs and an expected 2-hour hearing at a cost of \$456.

This material does not need to be discussed at the Sept. 14, 2017, EAIC meeting but should be available for your discussions at the SJR 27 subcommittee meetings in November 2017.

Pat



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2019 Biennium

Bill #	SB0371	Title:	Revise workers' compensation insurance and dissolve the state fund
Primary Sponsor:	Moore, Frederick (Eric)	Status:	As Introduced

- | | | |
|---|---|--|
| <input type="checkbox"/> Significant Local Gov Impact | <input type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

To open the fiscal Summary spreadsheet, right click on the spreadsheet, select Worksheet Object/Edit. To exit the spreadsheet, click outside of the spreadsheet.

	<u>FY 2018 Difference</u>	<u>FY 2019 Difference</u>	<u>FY 2020 Difference</u>	<u>FY 2021 Difference</u>
Expenditures:				
General Fund	\$0	(\$7,310,691)	(\$7,097,584)	(\$6,477,455)
State Special Revenue	\$0	\$200,676,955	\$83,631,762	\$67,999,207
Federal Special Revenue	\$0	\$0	\$0	\$0
Other	\$0	\$1,385,101,164	(\$196,201,307)	(\$190,960,415)
Revenue:				
General Fund	\$0	\$0	\$0	\$0
State Special Revenue	\$0	\$1,701,777,740	\$32,773,632	\$29,319,967
Federal Special Revenue	\$0	\$0	\$0	\$0
Other	\$0	(\$212,223,740)	(\$211,499,632)	(\$212,412,967)
Net Impact-General Fund Balance:	<u><u>\$0</u></u>	<u><u>\$7,310,691</u></u>	<u><u>\$7,097,584</u></u>	<u><u>\$6,477,455</u></u>

Description of fiscal impact:

The full fiscal impact on the Montana workers compensation system, the State of Montana and the state fund dissolution trust cannot be fully determined. Some significant items related to revenues and expenditures are noted.

The Montana State Fund (MSF) will be dissolved. All MSF assets will be transferred to the state fund dissolution trust. The Department of Labor and Industry (DLI), and/or residual market plan (RMP or plan no. 4) will be responsible for procuring or assuming all the business operations of MSF including claim management, policy servicing, and payment of all obligations.

MSF's role to act as the residual market carrier or guaranteed market for Montana will be eliminated. An RMP will be created and implemented requiring each plan no. 2 insurer to participate. The RMP may provide that a plan no. 2 insurer may meet its obligation under this section through direct policy assignment, participation in a reinsurance pooling mechanism, or otherwise.

All MSF assets will be placed in the 'state fund dissolution trust' to fund the claim runoff. All income from the trust must first be used for the runoff of state fund claims and, if this income is insufficient, to pay current claim benefits and expenses, trust principal can be withdrawn as authorized. Ultimate liability for any unfunded claim benefits and expenses will be with the State of Montana.

The trust will be reviewed annually and 50% of the principal exceeding a determined required level of principal may be utilized or appropriated as determined by a three-fourths majority of each house.

As of July 1, 2018, MSF will no longer issue workers' compensation insurance policies and MSF policyholders will be required to obtain policies with plan no. 2 insurers or in the RMP. MSF will have to provide for the cancellation of all inforce policies effective July 1, 2018. DLI will be responsible for providing any pro-rata policy refunds and policy reconciliations.

The Commissioner of DLI, in consultation with the Department of Administration, shall dispose of all remaining assets, wind up the affairs of the state fund, and dissolve the state fund.

The Old Fund liability will be funded by the dissolution trust fund managed by DLI.

FISCAL ANALYSIS

Assumptions:

1. Based on the annual statement filed with the State Auditor's Office for the year ending 12/3/16, MSF had \$1.66 billion in total assets, \$1.14 billion in liabilities, and \$526 million of Policyholders' Equity.
2. MSF will cease to collect premium effective July 1, 2018. MSF estimates the lost premium revenue to be: \$174.4 million in FY19; \$178.7 million in FY20; and, \$183.1 million in FY21.
3. There will be revenue from investment income on the declining balance of the state fund dissolution trust. Due to multiple unknown factors this amount cannot accurately be determined. A broad estimate of investment income assuming a 3% return would indicate: \$37.8 million in FY19; \$32.8 million in FY20; and, \$29.3 million in FY21.
4. The MSF dissolution will require a one-time contribution to Montana Public Employees Retirement Association (MPERA) of an estimated \$83 million out of state fund assets. This transfer will occur 7/1/2018.
5. MSF will pay claim benefit and loss adjustment expense through June 30, 2018. DLI will be responsible for all payments beginning July 1, 2018.
6. Based on actuarial analysis as of 12/3/16 claim benefit payments and loss adjustment expense on claims that occurred on or after July 1, 1990, are estimated to be: \$108.6 million - FY19; \$76.5 million - FY20; and, \$61.5 million - FY21 as displayed above, however, benefit payments will continue for decades. These amounts will be funded by the state fund dissolution trust.
7. Based on State Employees Protection Act, MCA, 2-18-1205, there could be expenditures for job retraining or other potential expenses related to the dissolution. Ongoing health insurance costs are as much as an estimated \$1.8 million for 285 employees laid off (285 current employees * \$1,054 current monthly payment * 6 payments = \$1,802,340).

8. MSF currently pays State of Montana agencies \$2.3 million for various IT, administration, and financial services and fees. These central costs would have to be redistributed to the remaining agencies effective 7/1/18. The impact of this redistribution is not included in this fiscal note.
9. All Old Fund expenditures are currently funded by general fund. Effective July 1, 2018 Old Fund expenditures will be funded by the state fund dissolution trust.
10. The Office of Budget and Program Planning included \$7.3 million for FY19 in the Executive budget. MSF staff estimates the FY20 and FY21 Old Fund estimated expenditures to be \$7.1 million and \$6.5 million respectively. These amounts will be funded by the state fund dissolution trust.
11. Creation, implementation and administration of the RMP will require contracted use of an advisory organization likely to be the National Council on Compensation Insurance (NCCI). The cost for this service is unknown.
12. MSF completes financial reporting on a calendar year basis. The Old Fund financial reporting is on a July 1 through June 30 fiscal period as is this fiscal note template.
13. DLI may determine and distribute policyholder dividends. No assumed dividend has been included in the fiscal note estimate. A dividend distribution will reduce the amount of investment income. MSF Board of directors declared a policyholder dividend of \$35 million on September 16, 2016.
14. The following table does not encompass all expenditures and revenue impacts but attempts to identify the significant items impacted by this legislation.

To open the spreadsheet below, right click on the spreadsheet, select Worksheet Object/Edit. To exit the spreadsheet, click outside of the spreadsheet.

	<u>FY 2018</u> <u>Difference</u>	<u>FY 2019</u> <u>Difference</u>	<u>FY 2020</u> <u>Difference</u>	<u>FY 2021</u> <u>Difference</u>
<u>Fiscal Impact:</u>				
FTE	0.00	(307.00)	(307.00)	(307.00)
<u>Expenditures:</u>				
Personal Services	\$0	(\$29,017,850)	(\$30,101,282)	(\$30,703,308)
Operating Expenses	\$0	(\$21,691,699)	(\$22,064,772)	(\$22,322,790)
Equipment	\$0	(\$5,239,776)	(\$3,599,776)	(\$508,736)
Benefits	\$0	(\$28,957,801)	(\$63,409,838)	(\$75,407,453)
Transfers	\$0	\$1,663,374,554	(\$491,461)	(\$496,376)
TOTAL Expenditures	\$0	\$1,578,467,428	(\$119,667,129)	(\$129,438,663)
<u>Funding of Expenditures:</u>				
General Fund (01)	\$0	(\$7,310,691)	(\$7,097,584)	(\$6,477,455)
State Special Revenue (02)	\$0	\$200,676,955	\$83,631,762	\$67,999,207
Federal Special Revenue (03)	\$0	\$0	\$0	\$0
Other	\$0	\$1,385,101,164	(\$196,201,307)	(\$190,960,415)
TOTAL Funding of Exp.	\$0	\$1,578,467,428	(\$119,667,129)	(\$129,438,663)
<u>Revenues:</u>				
General Fund (01)	\$0	\$0	\$0	\$0
State Special Revenue (02)	\$0	\$1,701,777,740	\$32,773,632	\$29,319,967
Federal Special Revenue (03)	\$0	\$0	\$0	\$0
Other	\$0	(\$212,223,740)	(\$211,499,632)	(\$212,412,967)
TOTAL Revenues	\$0	\$1,489,554,000	(\$178,726,000)	(\$183,093,000)
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	\$0	\$7,310,691	\$7,097,584	\$6,477,455
State Special Revenue (02)	\$0	\$1,501,100,785	(\$50,858,130)	(\$38,679,240)
Federal Special Revenue (03)	\$0	\$0	\$0	\$0
Other	\$0	(\$1,597,324,904)	(\$15,298,325)	(\$21,452,552)

Effect on County or Other Local Revenues or Expenditures:

1.

Long-Term Impacts:

- Workers compensation claim liabilities are long term obligations, sometimes taking up to 40 to 50 years to close. The total claim liability is susceptible to significant variances and it is common to have development, or increasing costs, due to variables like new treatment options, medical inflation and court cases.

Technical Notes:

- All MSF assets and interest income on these assets are held in trust, 39-71-2316, 39-71-2320 and, 39-71-2322, MCA, and can only be expended for the purpose the money was collected. Use of MSF assets for old fund liabilities or other purposes is inconsistent with the contractual and statutory limitations on MSF assets.

- 50% of the amount that exceeds the required principal may be utilized or appropriated for an alternative purpose(s) by a three-quarter vote of each house.
2. In New Section 7 (3), it is unclear as to whether the legislature can appropriate and use 50% of the dissolution trust income prior to complete runoff of all claims.
 3. The recitals (Where as clauses) contain inaccuracies and unsupported conclusions.
 4. The RMP has the obligation to provide for the orderly and efficient dissolution of MSF including: transition of the MSF policies to private insurers or the RMP; transition of MSF employees to state or private employment or retirement; and satisfaction of all MSF obligations in coordination with DOA (Pages 6-8 of bill draft). Section 2 conflicts with this as it states that the Commissioner may contract for the transition of policies, risks and obligations. This further conflicts with the DLI being required to provide for the orderly dissolution and transfer policies.
 5. Section 4 requires the dissolution of MSF upon establishment of the RMP. A conflict exists as the dissolution section is effective on 7/1/2018. If the RMP is established prior to 7/1/18 it is unclear as to when MSF dissolves.
 6. MSF has multiple reinsurance contracts dating back to 1993 that require ongoing monitoring and accounting with a reinsurance broker, these adjustments can significantly impact claim liability and recoverables. These contracts include language prohibiting either party from assigning the contract without the prior written consent of the other, which consent may be withheld by either party in its sole discretion.
 7. The bill requires DLI to act in the role as regulator and as a substitute for the insurer or real party in interest in claim administration creating a potential conflict of interest. (See Sky Country v. State Compensation Insurance Fund, WCC No. 8809-4913).
 8. The bill does not identify funding or appropriations to DLI or CSI to accommodate the additional dissolution and implementation costs to these agencies.

Sponsor's Initials

Date

Budget Director's Initials

Date

Fiscal note prepared by: _____

Agency: _____

Phone number: _____

Summary of SB 371:

SB 371 in the 2017 Montana Legislative session moved to dissolve the Montana State Fund (MSF) and transition Montana's workers' compensation system to an entirely private insurer driven market. The bill allowed a transition team to be set up to ensure all current MSF policies were transitioned to a private insurer with no interruption of coverage. The bill also discussed how to adjust all current MSF liabilities going forward. The Department of Labor & Industry would be required to establish a mechanism, either internally or through a 3rd party, to run-off current liabilities until completion. These processes would be paid for by a trust established with the reserves currently held by MSF. The department anticipates some new expenses to the trust stemming from transition efforts; however, we also anticipate that the annual expenses of the trust will decrease from their current level as employers move to the private market, or obtain insurance through Plan No. 4, and current claim liabilities are removed through closure or settlement. The department also anticipates that there could be a shift in some resources, as the bill would allow for a portion of the interest on these reserves, and eventually the reserves themselves, to be utilized for purposes other than the management of the state fund liabilities.

Some of Montana's challenges include frequency of injury and rate setting practices of insurers. Increased safety education efforts have also improved the state's performance related to frequency of injury, although there is still work to be done in that area. This bill aims to address the last factor rating our performance – rate setting practices of insurers. There has been little policy input from the Legislature to influence the way insurers set their rates for the guaranteed market. Most other states have threshold requirements that must be met before an employer qualifies for the guaranteed market.

SB 371 hypothesizes that, if the state fund were dissolved and deregulated, competition for market share would increase, causing total premium for the state to decrease.

Summary of Fiscal Impacts:

The bill requires that the department provide for the orderly and efficient dissolution of the state compensation insurance fund. It allows the commissioner to contract with a qualified contractor to fulfill this requirement. The bill also allows the commissioner to appoint a transition team to oversee such a contract. The department anticipates that there would be expenses associated with such a contract, as well as travel and per diem expenses related to the transition team.

Section 5 of the bill requires the commissioner to designate an entity responsible for administering the runoff of workers' compensation claims against and being administered by the state fund. That function could be absorbed by the department and completed by department staff (to be hired), or contracted out to a qualified contractor. The runoff of these claims, including all loss adjustment expenses (expenses associated with claims management), must be paid from the state fund dissolution trust, which is created from current state fund reserves. The department anticipates that, regardless of the method used to administer these claims, the loss adjustment expenses would remain at approximately the same level as is currently being incurred at state fund. In addition, it is anticipated that annual claims expense of the trust would decrease from the current level as employers move into the private

market or obtain insurance through Plan No. 4. As such, the department would not require any new revenue to carry out these duties, but would simply require appropriation. State Fund's anticipated loss adjustment expenses for FY 2017 were \$22,732,147.

The bill also requires that the commissioner establish a residual market program and pool (Plan No. 4) in order to make workers' compensation insurance coverage available to the guaranteed market.

Rulemaking costs are anticipated with relation to the establishment of Plan No. 4, including but not limited to: establishing criteria for obtaining insurance through Plan No. 4, defining participation of Plan No. 2 insurers and apportionment of risk amongst Plan No. 2 insurers. The department will need to file and publish a rule notice and adoption notice with the Secretary of State. Total cost for filing and publishing with the Secretary of State is \$60 per page. The department will also be required to hold a hearing for public comment on the rule notice. A two-hour rule hearing typically costs the department \$456.

The department would need to contract with an advisory organization designated by the commissioner of insurance to implement and administer Plan No. 4. The costs associated with this contract would be assessed to private insurers, and as such, there would be no fiscal impact to the department.

Section 6 (3)(b)(i) states that the Commissioner shall determine, on July 1 of each year, the required principal of the state fund dissolution trust for the following year. The department will be required to contract with a qualified independent actuary to complete this calculation. MSF has the same requirement, so this cost would be included in the anticipated loss adjustment expenses discussed above, and would not be an increase above current expenses.

If the current trust principal exceeds the required trust principal for the following year, then 50% of the amount that exceeds the required principal may be utilized or appropriated as determined by a vote of three-fourths of the members of each house of the legislature. As of December 31, 2016, state fund reserves were \$921,531,632. The department is unable to determine at this time what amount of that trust principal would be available to the Legislature for this use.

Upon complete runoff of all claims and expenses of the dissolution trust fund, the legislature may determine the use and appropriation of up to 50% of the biennial income of the trust fund. In addition, with a vote of three-fourths of the members of each house, the legislature may appropriate any remaining portion of the trust fund principal as well. At this point, the department has no way to estimate what these principal and interest balances may be that would be available for expenditure. We estimate that runoff of all claims and expenses would occur in 40 to 50 years.

The department is currently unable to determine what portion of state fund's current policy holders would be eligible for participation in Plan No. 4. Claim liability and the number of employers eligible to participate in Plan No. 4 could be estimated with access to certain statistical information from the state fund and other private insurers in the state. If the Department had access to policy specific demographic and performance data, a clear picture of what the market may look like in the future could be realized. Examples of the type of demographic and performance data required for this analysis include: total payroll, total premium, loss cost multiplier, schedule rating, number of claims, total losses (medical), total losses (indemnity), e-mod, and total reserves.

Section 43 of the bill removes the requirement for state agencies to purchase workers' compensation insurance through the state fund. This would leave the State with two options for obtaining workers'

compensation coverage for its employees. The first option would be to become self-insured. The second option would be to procure workers' compensation insurance on the competitive private market. It is unknown what the impact of such a move would mean with regard to the workers' compensation premiums currently paid by the State. In FY 2017, the State paid approximately \$17.2 million in workers' compensation premiums.